(4)

No. 89-1990

Supreme Court, U.S.
FILED
SEP 5 1990
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

TENNESSEE GAS PIPELINE COMPANY,
Petitioner,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

REPLY BRIEF OF PETITIONER

VINCENT F. EWELL, JR.
MARGARET L. BOLLINGER
PATRICK A. JOHNSON
TENNECO GAS
Post Office Box 2511
Houston, Texas 77252
(713) 757-4018

REX E. LEE *
CARTER G. PHILLIPS
MARK D. HOPSON
LOREEN M. MARCIL
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000

HAROLD L. TALISMAN
ROBERT H. BENNA
ROBERT G. KERN
WRIGHT & TALISMAN, P.C.
1050 17th Street, N.W.
Washington, D.C. 20036
(202) 331-1194

Counsel for Petitioner

* Counsel of Record

September 5, 1990

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

TABLE OF CONTENTS

	Page
CONCLUSION	10

TABLE OF AUTHORITIES

CASES

Associated Gas Distributors v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988)	9
Chevron U.S.A., Inc. v. *NRDC*, 467 U.S. 837 (1984)	1, 2, 9
Maislin Indus., U.S., Inc. v. *Primary Steel, Inc.*, 110 S.Ct. 2759 (1990)	5, 6
Mobil Oil Exploration and Producing Southeast, Inc. v. *FERC*, 885 F.2d 209 (5th Cir. 1989), *cert. granted sub nom., Mobil Oil Exploration and Producing Southeast, Inc.* v. *United Distribution Cos.*, 110 S.Ct. 2585 (1990)	3
Transcontinental Gas Pipe Line Corp. v. *FERC*, No. 88-1741, slip op. (D.C. Cir. July 17, 1990)	8

STATUTES

Interstate Commerce Act, ch. 104, 24 Stat. 379 49 U.S.C. § 10761(a)	5
Natural Gas Act of 1938, ch. 556, 52 Stat. 821 (codified at 15 U.S.C. §§ 717-717w) 717c(a)	3

ADMINISTRATIVE MATERIALS

18 C.F.R. § 154.63(e)(2)	7

ADMINISTRATIVE ORDERS AND DECISIONS

Tennessee Gas Pipeline Co., 31 FERC ¶ 61,308, *reh'g denied*, 34 FERC ¶ 61,219	8

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 89-1990

TENNESSEE GAS PIPELINE COMPANY,
Petitioner,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

REPLY BRIEF OF PETITIONER

---

1. As explained in the petition, the fundamental legal error committed by the court below was the failure of that court to accord the Federal Energy Regulatory Commission ("FERC") the deference mandated by *Chevron U.S.A., Inc.* v. *NRDC*, 467 U.S. 837 (1984), in reviewing this complex and important ratemaking proceeding. Respondents Associated Gas Distributors, *et al.* concede (Opp. 22) that the D.C. Circuit, in setting aside the FERC Order No. 500 rate methodology at issue here, accorded *no deference* whatsoever to the agency's decision that the methodology would result in "just and rea-

sonable" rates. Opp. 22.[1] The court below simply rejected FERC's interpretation of the Natural Gas Act ("NGA" or "Act"), as reflected in the ratemaking methodology at issue, without regard to either the language or structure of the Act. Instead, the court rested its decision solely upon its novel premise that "predictability is the whole purpose of the well established 'filed rate doctrine' . . . ." Pet. App. 15a (citing *Columbia Gas Transmission Corp.* v. *FERC*, 831 F.2d 1135, 1141 (D.C. Cir. 1987)). Thus, the court of appeals squarely rejected FERC's interpretation of the NGA, under which "reli[ance] on historical purchase data" in allocating current costs to current customers "does not turn [a ratemaking methodology] into retroactive ratemaking" or a violation of the filed rate doctrine. Pet. App. 158a. In doing so, the court undermined FERC's reasonable solution to a staggering industry problem, the enormity of which is not disputed by respondents.

Respondents argue that the usual deference to agency action mandated by *Chevron* is not applicable in this case because FERC's order was "barred by the filed rate doctrine." Opp. 16. As an initial matter and as FERC found, its order did not violate the filed rate doctrine. Moreover, the filed rate doctrine is not a talismanic higher authority that can be mechanically invoked to overrule a decision that Congress has entrusted to FERC. See Pet. 12-13; *infra*. Rather, both the filed rate doctrine and the cost causation doctrine, the two central ratemaking principles at issue in this case, are interpretive principles that derive from language and structure of the NGA itself. Pet. 8-9. Given the "sea change" that the natural gas industry is undergoing at the present time (see Pet. App. 33a (Wald J., dissenting from denial of rehearing *en banc*)), loyalty to the model of judicial review embodied in *Chevron* should

---

[1] Respondents Process Gas Consumers Group, *et al.* ("PGCG") are entirely silent on the primary question presented regarding *Chevron* deference and focus instead on an effort to defend the decision below on the merits. PGCG Opp. 4-10.

have resulted in greater—not lesser—deference to the FERC's efforts to harmonize those statutory principles in resolving the "take-or-pay crisis." *Id.* at 34a.

2. Respondents do not—and cannot—contest the nationwide impact of the decision below and, accordingly, the need for review of that decision by this Court. Petitioner and other interstate pipelines already have incurred billions of dollars in take-or-pay buy-out and buy-down costs in reliance on FERC's 1987 adoption of Order No. 500, which this case implemented. See Pet. 10 (FERC estimates that pipelines had incurred over $8 billion in buy-out or buy-down costs and had recovered $3.4 billion of those costs under the purchase deficiency allocation method); Pet. App. 48a. Although respondents focus solely on Tennessee Gas Pipeline Company and its customers, this Court's review of the decision below would affect not only those parties but the resolution of the take-or-pay crisis that has convulsed the natural gas industry for nearly a decade. See Pet. 4-5, 10 (over 300 orders issued by FERC on proposals by 22 pipelines to recover buy-out and buy-down costs). Compare *Mobil Oil Expioration and Producing Southeast, Inc.* v. *FERC*, 885 F.2d 209 (5th Cir. 1989), *cert. granted sub nom., Mobil Oil Exploration and Producing Southeast, Inc.* v. *United Distribution Cos.*, 110 S.Ct. 2585 (1990).

Respondents blithely assert that FERC's inability to implement the purchase deficiency allocation method of Order No. 500 is not critical because there are other, more "equitable" means to allocate take-or-pay costs. Opp. 23. Putting aside that it is the FERC, and not respondents, that is charged under Section 4(a) of the NGA, 15 U.S.C. § 717c(a), with resolving such questions, respondents simply ignore the enormous amount of time and money that has been expended since 1987 in the adoption and implementation of the Order No. 500 methodology (Pet. 7-10) and the significance of the

fact that FERC has considered and found inferior to the purchase deficiency allocation method each of the "alternatives" proposed.[2] See Opp. 24-25.[3]

3. Respondents devote the primary portion of their brief to defending the decision below on the merits, arguing that the decision below was "clearly correct" (Opp. 16) because the methodology employed here was inconsistent with the NGA and "contrary to the authoritative construction of [that] statute by this Court" (Opp. 22). Petitioner agrees in large part with respondents' lengthy exegis of the language and prior judicial interpretation of the NGA. Opp. 13-19. But, the primary lesson that respondents draw from this analysis—that the NGA and the decisions of this Court "unambiguously bar[] FERC" from ordering a "retroactive" rate change (Opp. 13, 16)—simply ignores the fact that FERC has not authorized a "retroactive" change and begs the question of whether the allocation of *current* take-or-pay costs based on the historical purchasing practices that give rise to those costs constitutes a permissible rate mechanism under the NGA. That question has not been resolved by any decision of this Court. This Court simply has never held that the filed rate doctrine provides that past purchasing decisions can never be a

---

[2] Respondents similarly ignore the enormous practical implications of the D.C. Circuit's invalidation of the purchase deficiency allocation method. See Pet. 20.

[3] As Chief Judge Wald explained:

> [E]ven if some costs could be passed on to future consumers, that would still mean that total losses would be allocated inequitably. Those consumers who are in a position to take advantage of open-access shipping will bear proportionately less of the loss than those who cannot—even though the former (by switching to other pipelines) are the ones responsible for the loss.

Pet. App. 34a (Wald, J., dissenting from denial of rehearing *en banc*).

basis of allocating costs in subsequent ratemaking proceedings.[4]

For example, respondents state that the holding of *Maislin Indus., U.S., Inc.* v. *Primary Steel, Inc.*, 110 S.Ct. 2759, 2770 (1990) "is squarely on point." Opp. 13 n.20. *Maislin* involved a motor carrier, subject to Interstate Commerce Commission ("ICC") rate regulation, 49 U.S.C. § 10761(a), that had charged and received rates lower than its filed rate. When the carrier later commenced an action to recover the deficiency, this Court held that an ICC policy which would preclude the carrier from recovering those deficiencies was inconsistent with the statutory requirement that a carrier "not charge or receive a different compensation . . . than the rate specified in the tariff." 110 S.Ct. at 2762, citing 49 U.S.C. § 10761(a). Thus, *Maislin* followed what petitioner had identified as the "purpose of the filed rate doctrine"—the " 'preservation of the agency's primary jurisdiction over reasonableness of rates and the need to insure that regulated companies charge only those rates of which the agency has made cognizant.' " Pet. 12 (quoting *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 578 (1981) (*"Arkla"*)). In this case, by contrast, respondents concede that recovery of take-or-pay costs would be conducted pursuant to a filed rate. See Opp. 17 ("Tennessee of course filed a new tariff containing

---

[4] Respondents argue vigorously that "certainty" is a core element of the filed rate doctrine and that the order here undermines prior purchasing decisions in a way that vitiates the "certainty" principle. But the "certainty" that the filed rate promotes is fully satisfied here by the existence of a filed rate that incorporates the allocated charges for current costs based on past practices. The peculiar notion of certainty upon which respondents rely proves too much; under their theory FERC never could employ a three-day peak or other similar methodology because that would involve ratemaking based upon conduct when the regulated entity did not know that its behavior would alter its future rates. Yet, as we explained in the petition, such methods have long been approved in ratemaking. Pet. 21.

the surcharge before actually billing its customers"). *Maislin* thus is inapposite.

Similarly, in *Arkla* this Court held that the filed rate doctrine prohibits a state court from calculating damages in a breach of contract action based on the assumption that, if a higher rate had been filed, the Federal Power Commission would have approved it. That general principle defining the core of the filed rate doctrine says nothing about FERC's use of past purchasing practices as a method of allocating current costs. Accordingly, *Arkla* offers no insight into the proper disposition of this case.

Although the statute and the decisions of this Court are silent on the specific question presented, FERC squarely faced the issue and determined that the cost causation doctrine embodied in the just and reasonable rate requirement would best be served by permitting a pipeline to allocate a portion of its costs *currently* incurred to buy-down or buy-out its take-or-pay obligations among its customers according to the extent to which each customer had contributed to the pipeline's take-or-pay problems. See Pet. App. 113a-115a. In addition, the court of appeals recognized that these were current costs. FERC further noted that the purchase deficiency allocation method was consistent with "the treatment usually accorded costs incurred in resolving any contract dispute . . . ." Pet. App. 114a.

Respondents respond to these findings by scoffing at FERC's conclusion that the costs of take-or-pay are "current" costs. Opp. 19. "First," argue respondents, the costs are not current because "there is ample evidence that Tennessee knew by late 1982 that it had a significant [take-or-pay] problem." *Id.* However, the time when Tennessee, or anyone else, realized the nature or extent of the take-or-pay crisis is irrelevant; the relevant fact is that the costs of buying-out or reforming take-or-pay liabilities are current costs, which could not have been recovered until they were "known and measurable

with reasonable accuracy." 18 C.F.R. § 154.63(e)(2); Pet. App. 114a. Second, respondents argue that "FERC's insistence that the costs are 'current' only reinforces the objection to assessing the charges solely on the basis of respondents' [historical] purchase decisions . . . ." Opp. 19. But, this argument simply blurs the distinction between the nature of take-or-pay liabilities as current costs, see Pet. 7-8; Opp. 8-9, with the methodology by which these costs may be partially allocated to pipeline customers.

Respondents argue (Opp. 17 n.24) that this case can be compared to a situation where General Motors after selling a car seeks to obtain additional compensation after the fact. But the analogy is fatally flawed because Tennessee is a regulated entity that has on-going service obligations and significant restrictions on what it can include in the rates it charges. Thus, the take-or-pay liabilities could not be included in any rates paid by respondents until those liabilities were actually incurred by Tennessee, which means that they could not be allocated until now. GM, by contrast, remains free to price its product limited solely by the market and can and does include anticipated but not actually incurred costs in the price.

Respondents state that it "is obvious" that any charge imposed on a customer that "had terminated its relationship with Tennessee after 1986" would be a charge for "*past* gas service" and therefore a retroactive rate increase. Opp. 16 n.23 (emphasis in original). Although that may pose an interesting question, respondents' brief does not, and could not, suggest that it is anything more than hypothetical. In fact, the settlement approved in this case would not impose any portion of Tennessee's current take-or-pay costs on any party that is not a current Tennessee customer.[5]

---

[5] Respondents PGCG claim that "two of Tennessee's customers", Columbia Gas Transmission Corporation ("Columbia") and Inland

Respondents' final argument in support of the position that the opinion below "was plainly correct"—an argument not relied upon by the court below—is that they may not have "caused" Tennessee to incur its current take-or-pay costs. Thus, respondents complain that they did not "induce[]" Tennessee to enter into take-or-pay obligations and did not engage in any "breach of contract or violation of tariff." Opp. 4, 19. But FERC made a finding based on substantial record evidence, which was not set aside by the court of appeals, that there was a causal link between the purchase reductions of Tennessee's customers and Tennessee's incurrence of take-or-pay liability. Pet. App. 76a ("it is apparent that a decline in a customer's purchases from Tennessee translates directly to a decline in Tennessee's ability to meet its purchase obligations"). See also *Transcontinental Gas Pipe Line Corp.* v. *FERC*, No. 88-1741, slip op. (D.C. Cir. July 17, 1990).[6]

Gas Company ("Inland"), have been subject to retroactive take-or-pay charges for abandoned service. (PGCG Opp. 9-10 n.9). However, neither Columbia nor Inland nor any other respondent in Tennessee's case has made this claim or even suggested that it is not a current Tennessee customer. Nor could they. In fact, the reductions in contract referred to were effective March 1, 1986 pursuant to *Tennessee Gas Pipeline Co.*, 31 FERC ¶ 61,308, *reh'g denied*, 34 FERC ¶ 61,219. Thus, except for ten months of 1986, Columbia's and Inland's contract entitlements remained constant throughout the base and deficiency periods. The ten month exception might be important if (1) take-or-pay costs were being assessed on the basis of contract entitlement, (2) Columbia and Inland were purchasing near their entitlement for that period, or (3) Columbia and Inland had terminated their contractual relationship with Tennessee prior to the order allocating take-or-pay costs. However, none of these situations in fact occurred and, thus, no Tennessee customer has been charged for take-or-pay costs without receiving current service from Tennessee.

[6] Respondents' suggestion that Tennessee somehow acted imprudently in incurring the take-or-pay costs at issue (Opp. 2-3, 20) is inconsistent with the findings of the Commission and the ALJ. See Pet. App. 70a ("totality of the record shows that Tennessee was

As explained in detail in the relevant FERC Orders and in the petition (Pet. 5-7 (discussing Order No. 380 and Order No. 436)), respondents received the benefits of a radical restructuring of the natural gas industry to a more competitive model. FERC's orders since 1984 freed pipeline customers, such as respondents, from their minimum bill obligations to pipelines (Pet. 5-6) and provided them with open access to transport their own purchases of gas (purchased on the spot market) in competition with the pipelines' own gas sales. As the D.C. Circuit itself recognized, the pipelines thereby became the "fall guys," bearing the burden of billions of dollars of uneconomic contracts brought about by shifts in market prices and exacerbated by these changes in regulatory policies. See *Associated Gas Distributors* v. *FERC*, 824 F.2d 981, 1021 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988). FERC's finding—repeatedly echoed by the D.C. Circuit (Pet. 7)—that respondents' reductions in purchases in response to these regulatory developments were partially responsible for Tennessee's take-or-pay liabilities was clearly correct.

* * * *

FERC's application of the purchase deficiency allocation method of Order No. 500 to petitioner was a single integral step in FERC's efforts to allocate the billions of dollars of take-or-pay liabilities incurred in large part due to FERC's radical restructuring of the natural gas industry. See Pet. 5-8. The decision below striking down that methodology places a limitation, unsupported by any specific statutory language, on FERC's plenary ratemaking authority in a manner flatly inconsistent with the deferential standard of review mandated by *Chevron*. Given the substantial nationwide impact of this decision on natural gas companies and consumers and the inter-

---

prudent in incurring its take-or-pay obligations"); 104a ("[n]o serious allegation of imprudence has been raised as an obstacle to Commission approval of a settlement proposal in this case").

relationship of Order No. 500 with other statutory and regulatory developments that constitute the "sea change in the natural gas industry," Pet. 14, the decision below clearly warrants review by this Court.

CONCLUSION

For the reasons set forth above and those stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

VINCENT F. EWELL, JR.
MARGARET L. BOLLINGER
PATRICK A. JOHNSON
TENNECO GAS
Post Office Box 2511
Houston, Texas 77252
(713) 757-4018

REX E. LEE *
CARTER G. PHILLIPS
MARK D. HOPSON
LOREEN M. MARCIL
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000

HAROLD L. TALISMAN
ROBERT H. BENNA
ROBERT G. KERN
WRIGHT & TALISMAN, P.C.
1050 17th Street, N.W.
Washington, D.C. 20036
(202) 331-1194

Counsel for Petitioner

* Counsel of Record

September 5, 1990